NEW YORK COUNTY
NYCLA
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VIA HAND-DELIVERY

COMMENT

March 22, 2010

U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, D.C. 20581
Attention: Mr. David Stawick, Secretary

***Re: Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries*, RIN No. 3038-AC61 (January 20, 2010)**

Dear Mr. Stawick:

This letter is submitted on behalf of the Committee on Futures & Derivatives Regulation ("Committee")[1] of the New York County Lawyers' Association ("NYCLA") in response to the Commodity Futures Trading Commission's ("Commission" or "CFTC") Proposed Rules regarding the Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, RIN 3038-AC61 ("Proposed Rule").[2] This letter was prepared by members of the Committee. The comments expressed in this letter represent the views of the Committee only and have not been approved by NYCLA and, therefore, do not represent the official position of NYCLA.

The Committee would like to thank the Commission for this opportunity to comment on the Proposed Rule. Our Comments are organized in order of priority.

1. Proposed Rule 5.9 Should Be Rejected Because It Would Have A Significant and Negative Impact on the Retail Forex Industry

In the introductory section of the Proposed Rule, the Commission states that its primary objective in enacting regulations to govern the retail forex industry is to curb fraud in the retail forex marketplace.[3] While the Committee agrees and supports this important goal and many of the Commission's proposals that may further this aim, such as mandatory registration and increased reporting requirements, the Committee does not support the Commission's intent to decrease the leverage ratio of customer accounts as stated in Proposed Rule 5.9.

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[1] Committee Comment Drafting Sub-Committee: Sabeena Ahmed, Scott Ferber, Felix Shipkevich, and Stuart Shroff.
[2] Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 Fed. Reg. 3282 (proposed Jan. 20, 2010) (to be codified at 17 C.F.R. pts. 1, 3, 4, et al.)
[3] *Id.* at 3286 ("[T]he Commission has observed a number of improper practices that have raised concern, among them solicitation fraud, a lack of transparency in the pricing and execution of transactions, unresponsiveness to customer complaints, and the targeting of unsophisticated, elderly, low net worth and other vulnerable individuals.") (citation omitted).

In the event that Retail Foreign Exchange Dealers ("RFEDs") or Futures Commission Merchants ("FCMs") were required to maintain a leverage ratio of only 10-to-1 in their security deposit accounts, rather than the current 100-to-1 ratio, this would have a significant and negative impact on investors engaging in retail forex transactions through U.S.-regulated businesses. Specifically, the decrease in leverage would hamper the investors' ability to conduct these transactions in a profitable manner. Movements in the value of currencies are mostly a small fraction of a single unit—thereby increasing the need for leverage to facilitate these transactions. It is likely that were Proposed Rule 5.9 to go into effect, current U.S.-based retail forex investors would continue to engage in these highly leveraged transactions, but through brokers outside the purview of the CFTC. Thus, if the Proposed Rules were adopted as they are currently written, this could present dangers far greater than those currently anticipated by the Commission.

The effect of Proposed Rule 5.9 would indeed be a reduction in an investor's exposure to risk, as many current and potential investors would effectively be excluded from this market. With a ten-fold increase in the margin requirement, many retail traders, who generally trade mini-sized contracts requiring little up front capital, would not have additional capital to risk and would be prevented from trading in the U.S. market. This clearly contravenes Congress' intent in giving the CFTC jurisdiction over the industry. When the CFTC Reauthorization Act of 2008 was first passed, Congress explicitly stated that its intention for the Commission's new statutory authority was to "address fraud and retail transactions in foreign exchange markets," not to significantly reduce the number of investors in the market.[4]

To circumvent the new margin requirements, many U.S.-based retail forex investors, eager to trade forex, would shift their investments overseas to jurisdictions that lack the protections afforded by the Commission and would, therefore, be exposed to potentially greater fraudulent activity. A corresponding effect of Proposed Rule 5.9 is that U.S.-based RFEDs and FCMs will lose business and, accordingly, the U.S. will lose tax revenue.

The Commission states that the current 100-to-1 ratio subjects retail investors to substantial losses.[5] The Committee acknowledges that trading on margin can potentially expose a retail investor to substantial losses, but these losses are a risk that individuals engaging in these activities are aware of and accept when they enter into these transactions. If the Commission's intention is to reduce a retail investor's likelihood of experiencing loss, there are other, superior mechanisms that the Commission could consider adopting in lieu of decreasing leverage ratios. For example, the Commission's proposal to increase disclosure requirements would help make potential investors even more cognizant of the inherent risks of these transactions. The Commission could also consider passing a regulation mandating when an RFED or FCM must close out an investor's position or account.

Critics of the proposed leverage requirements believe that the Proposed Rule's purpose is to ban retail forex transactions. If this is the Commission's intent, then, as required by the Commodity Exchange Act ("CEA")[6], the Committee urges the CFTC to write a Proposed Rule that clearly states this intention and describes how the U.S. financial markets will benefit from excluding this activity.

For these reasons, the Committee respectfully recommends that the Commission not increase the amount a retail forex customer must maintain on reserve to ten percent, but instead maintain it at its

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[4] 153 Cong. Rec. S15433, 15441 (Dec. 13, 2007).
[5] *Supra* note 2, at 3290.
[6] 7 U.S.C. § 19(a)(2) (2006).

present level of one percent as designed by the industry's Designated Self-Regulatory Organization, the National Futures Association ("NFA").

2. Proposed Rule 1.10 Should Be Rejected on the Ground That It Is Anti-Competitive and Places an Undue Burden on Forex IBs

In addition to several related rules[7], Proposed Rule 1.10 requires an RFED or FCM to guarantee the performance of all persons who introduce accounts to a counterparty. Under these rules, any introducing broker ("IB") who introduces retail forex transactions must enter into a guarantee agreement with an RFED or FCM in order to participate in the U.S. forex industry. Requiring IBs to be guaranteed in order to participate in the forex market is anti-competitive and places an undue burden on IBs that introduce forex customers.

The Commission defends the Proposed Rules as necessary because persons who have traditionally introduced off-exchange retail forex customers to counterparties have not been required to register as IBs, and fraudulent solicitation and sales practices have been commonplace.[8] In the Commission's view, mandating that IBs be both registered and guaranteed will curtail the fraudulent and abusive sales practices of many of these IBs.

Although the Commission's rationale is compelling, there appears to be an inconsistency between the Commission's purported goal and the means by which it proposes to achieve this goal. The Rules effectively create two classes of IBs—those who introduce off-exchange retail forex customers to counterparties ("Forex IBs") and those who introduce customers who trade exchange-traded futures contracts to counterparties ("Futures IBs") —and subjects these classes to differential treatment.

Forex IBs must be *both* registered and guaranteed in order to participate in the forex market. This means that a Forex IB must find a guarantor or it is prevented from participating in the industry as an IB. Forex market makers are also prevented from the benefits of using outside salespersons *unless* they are in the position of being able to guarantee these IBs. In stark contrast, Futures IBs need only be registered and can choose whether to be guaranteed. There are fewer barriers imposed on Futures IBs; they can serve as outside salespersons without the burden of having to find a guarantor as a condition of their participation in the market. This standard grants Futures IBs and the futures exchanges with which they work a competitive advantage. It simultaneously places an undue burden on forex market makers and the ability of their outside salespersons to compete on an equal footing with other industry participants.

A quick study of other financial markets lends further support to the anti-competitive underpinnings of the Proposed Rules. No other industry, either domestically or internationally, imposes a comparable guarantee requirement on Forex IBs. In the U.S.-based futures markets, IBs can choose whether to operate within the market under a guarantee agreement. International markets, including jurisdictions with comparable regulatory regimes, like Australia, New Zealand, Canada, Germany and the United Kingdom, also safeguard the Forex IBs' right to decide whether to operate in the industry through a guarantee agreement with a forex counterparty.

Section 15(b) of the CEA specifically requires the Commission to adopt the least anti-competitive means of achieving a given objective.[9] As stated above, the Commission's objective for the Proposed

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[7] Proposed Rule, at 1.10(a)(4), 1.10(j)(3), 1.10(j)(9)(i)(A)(2) and 1.10(j)(9)(i)(B)(2); *see* Proposed Rule 5.18(h).
[8] *See supra* note 2 at 3287.
[9] 7 U.S.C. § 19(b) (2006).

Rule is to reduce fraud in the marketplace. There appears to be no clear correlation between a reduction in incidents of fraud and the requirement that Forex IBs be guaranteed. In fact, mandating the registration of Forex IBs alone could suffice in meeting the Commission's stated objective. As the NFA has publicly acknowledged, the bulk of enforcement activity occurs amongst unregistered industry participants. Additionally, a rule mandating that all U.S. IBs be registered could be coupled with other proposed rules, such as remitting certain Forex-specific disclosures to customers, to further strengthen the efficacy of the registration requirement and safeguard the Commission's stated objective of fighting industry abuse.

The Committee reminds the Commission that the *raison d'être* of the Proposed Rules is not the creation of obstacles to stifle an industry, but the elimination of fraud. Thus, the Committee requests that the Commission reconsider its Proposed Rule, which mandates guarantee agreements for Forex IBs.

3. Proposed Rule 5.5(e) Should Be Revised Because It Is Anti-Competitive

Proposed Rule 5.5(e) requires an RFED or FCM to provide each customer with certain disclosures for the most recent four quarters. Among the required disclosures is information pertaining to the number of retail forex accounts maintained and the number of such accounts that were profitable. The Proposed Rule also requires that RFEDs or FCMs keep records of its non-profitable accounts. Like Proposed Rule 1.10, the Committee believes that this Proposed Rule has anti-competitive underpinnings and should not be enacted. Mandating that an RFED or FCM disclose publicly its profitable and unprofitable accounts is a requirement unique only to the retail forex dealer. There is no comparable requirement imposed on FCMs with retail futures accounts. Moreover, there is no justification for this differential treatment.

Proposed Rule 5.5(e) mandates the disclosure of information that could be misleading to existing and prospective retail clients. The profitability of one account has no bearing on another account as each client's strategies and goals could differ significantly—much like those in other financial transactions. Clients could potentially see a highly profitable quarter and mistakenly believe that their account, too, will be profitable. Moreover, the Proposed Rule lists no calculation criteria and imposes no guidance on how to determine which accounts are profitable. It leaves FCMs or RFEDs free to develop their own criteria and unique methodology and decide for themselves which accounts are profitable and should be disclosed to market participants as profitable.

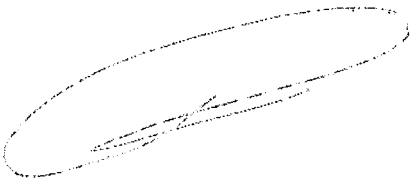
Consequently, Proposed Rule 5.5(e) seems to presume that the nature, value and number of unprofitable accounts somehow differ across the forex and futures industries. The Committee challenges this presumption and recommends that, before the Commission finalizes the Proposed Rules, it conduct a comprehensive study of unprofitable retail forex accounts as compared to unprofitable retail futures accounts. Such an examination would help the Commission truly determine whether reasonable and justifiable grounds exist for imposing this requirement on the U.S. forex dealer.

The Committee would like to end its comment letter by deferring to the statements of Congressman Timothy J. Walz during the June 4, 2009 hearing before the Subcommittee on General Farm Commodities and Risk Management of the House of Representatives' Committee on Agriculture. As Mr. Walz explained: "Since 1974, when the CFTC began to oversee trading in derivatives, it has been necessary for the CFTC to strike an appropriate balance to find the 'sweet spot' of regulation that would

protect investors but not stifle the industry."[10] Moreover, "Forex traders realize that there is a role for the government to play in creating a level playing field and making sure everyone plays by the rules. But what they do not want is heavy-handed regulation that will impede development of a new market that is widely used by many investors overseas but is just getting its footing in the United States."[11]

The Committee appreciates the opportunity to submit these comments for the Commission's review. Members of the Committee are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Sincerely,



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[10] *Hearing to Review Implications of the CFTC v. Zelener Case, Hearing Before the Subcomm. on General Farm Commodities and Risk Management of the H. Comm. on Agriculture*, 111th Cong. 3 (2009) (statement of Rep. Timothy A. Walz, Member, H. Comm. on Agriculture), *available at* http://www.house.gov/agriculture/democrats/testimony/111/111-17.pdf.

[11] *Id.*